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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
SOUTHERN DIVISION

PAUL RICE and JOSEPH RICE,
Plaintiffs,

v.

CHARLES SCHWAB, MOODY'S
INVESTORS SERVICE, and
STANDARD & POOR'S,
Defendants.

Case No. SACV 10-00398 CJC (MLGx)

**THE RATING AGENCIES' JOINT
MEMORANDUM OF POINTS AND
AUTHORITIES IN SUPPORT OF
THEIR MOTION TO DISMISS THE
SECOND AMENDED COMPLAINT**

Date: October 25, 2010
Time: 1:30 PM
Place: Courtroom 9(B)

Hon. Cormac J. Carney

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Defendants Standard & Poor's Financial Services, LLC ("S&P") and Moody's Investors Service, Inc. ("Moody's") (together the "CRAs"), respectfully submit this joint memorandum of law in support of their motion to dismiss, pursuant to Fed. R. Civ. P. 9(b) and 12(b)(6), the Second Amended Complaint (the "SAC") filed by plaintiffs Paul Rice and Joseph Rice (the "Plaintiffs").

I. INTRODUCTION

On August 4, 2010, this Court dismissed Plaintiffs' First Amended Complaint ("FAC") asserting claims for negligence, negligent misrepresentation and intentional misrepresentation. The Court identified several fatal errors in the FAC, including that Plaintiffs failed to allege "why [the CRAs'] statements are false" and otherwise failed to "allege[] their claims . . . with sufficient particularity" as required by Federal Rule of Civil Procedure 9(b). *See Paul Rice et al. v. Charles Schwab et al.*, No. 10-00398-CJC(MLGx), slip op. at 2 n.1 (C.D. Cal. Aug. 4, 2010) ("August 4 Order"), at 2. Although the Court granted Plaintiffs leave to replead, it cautioned that "[i]f Plaintiffs choose to amend their complaint," they must address the failings identified in the August 4 Order and "may wish to consider some of the CRAs' other arguments as well." *Id.*¹

Not surprisingly, Plaintiffs' SAC fails to cure the deficiencies identified in the August 4 Order and does not (and cannot) fix any of the other fatal flaws addressed in the CRAs' original motion to dismiss. Remarkably, a close inspection of Plaintiffs' SAC reveals that they have made only *two* substantive changes to their allegations: (i) they now include language asserting that the CRAs' ratings were "directly communicated" by the CRAs to Plaintiffs (¶16), and (ii) they now

¹ The basic facts alleged by Plaintiffs are set forth in the Court's August 4 Order and we will not belabor them here. Put simply, Plaintiffs demand compensation from the CRAs for their alleged losses in preferred stock issued by Fannie Mae and Freddie Mac. Plaintiffs claim they are entitled to this extraordinary relief because, prior to investing, they purportedly reviewed and relied on the CRAs' opinions about the creditworthiness of Fannie and Freddie.

1 purport to identify the dates on which Plaintiffs' obtained the respective CRAs'
2 credit ratings and Plaintiffs' location at the time they obtained those ratings. *See*
3 SAC ¶ 29. Neither of these new immaterial allegations begins to render the SAC
4 sufficient to state a claim.

5 The first new allegation – a bare attempt by Plaintiffs to allege a basis for
6 some sort of duty of care between themselves and the CRAs – is a red herring.
7 While Plaintiffs use the words “directly communicated,” a plain reading of the
8 entirety of the SAC reveals that Plaintiffs can only allege, at most, that they
9 purportedly received reports from their broker that happened to contain the CRAs'
10 publicly available ratings. Plaintiffs make no allegation of a single meeting, phone
11 call, letter or email to them from any of the CRAs. Indeed, Plaintiffs admit that the
12 ratings that appeared in these reports had been “published” by the CRAs to the
13 public at large. Moreover, direct communication, such as that which occurs in a
14 subscription agreement, is by itself insufficient as a matter of law, even if it did
15 occur. Plaintiffs do not (and cannot) allege that the ratings at issue were provided
16 for their own benefit or the benefit of any particular broker or investor. Thus,
17 Plaintiffs cannot demonstrate (as they must) that the CRAs' rating opinions
18 constituted any sort of personal investment advice, or that Plaintiffs had any
19 relationship – *or contact of any kind* – with either of the CRAs. Without this,
20 Plaintiffs cannot possibly demonstrate the existence of a duty of care, the
21 fundamental legal prerequisite to stating any claim for negligent misrepresentation.

22 Plaintiffs' second new allegation – that they received the ratings of each
23 CRA at a specific time and place – also fails to rescue the SAC. Although
24 Plaintiffs will contend that this allegation constitutes the “who,” “what,” “when”
25 and “where” of their claim, the allegation says nothing about the critical question
26 specifically identified by the Court in the August 4 Order: *i.e.*, “*why*” the CRAs'
27 alleged misstatements were false. *See also In re Glenfed, Inc. Securities Litigation*,
28 42 F.3d 1541, 1547-48 (9th Cir. 1994) (requiring plaintiffs to plead the

1 “circumstances indicating falseness”), *superseded in part by statute*, 15 U.S.C. §
2 78u-4 (b)(2) (1995) (increasing the pleading standard). Particularly here, where
3 Plaintiffs’ purported claims arise out of non-actionable statements of opinion, they
4 cannot approach meeting this fundamental pleading standard. Indeed, to meet their
5 burden, Plaintiffs would be required to plead particular facts to demonstrate that the
6 credit rating analysts responsible for the relevant CRA ratings had knowledge of the
7 alleged falsity of those ratings, *i.e.*, that the analysts actually *disbelieved* the ratings
8 for some particular reason. It is now clear, after having had three chances to make
9 such allegations, that Plaintiffs simply cannot do so.

10 Putting aside their two new, inconsequential allegations, Plaintiffs
11 otherwise rely wholesale on the very allegations contained in their dismissed FAC
12 that led to the Court’s prior order of dismissal. Obviously, those allegations
13 provide no more basis on which to state a claim now than they did on August 4,
14 2010, when then FAC was dismissed. Among other things, Plaintiffs continue to
15 allege (i) that the CRAs’ ratings on Fannie Mae and Freddie Mac securities were
16 “misleading and omitted material facts” (*compare* FAC ¶18 with SAC ¶ 18), and
17 (ii) that the CRAs “had knowledge that Fannie Mae and Freddie Mac were in
18 financial trouble and were bad risks.” (*Compare* FAC ¶ 18 with SAC ¶ 18). As
19 demonstrated in the CRAs’ earlier submission, and explained again below, such
20 conclusory allegations cannot constitute actionable misstatements by the CRAs,
21 particularly under the heightened standard imposed by Rule 9(b). Nor do these
22 allegations, or additional allegations copied from Plaintiffs’ earlier pleading, satisfy
23 the other elements necessary to state a claim for negligence, negligent
24 misrepresentation or fraud.

25 As explained below, Plaintiffs’ SAC also cannot avoid the preemptive
26 effects of The Credit Rating Agency Reform Act of 2006 (the “CRARA”), 15
27 U.S.C. § 78o-7(c)(1)-(2) (2006). Finally, Plaintiffs’ negligent misrepresentation
28 claim continues to be barred by fundamental principles of constitutional law, both

1 because credit ratings are, by their nature, non-actionable expressions of opinion
2 and because Plaintiffs fail to allege that the CRAs acted with actual malice.

3 For all these reasons, Plaintiffs claims should be dismissed, this time with
4 prejudice.

5 II. STANDARD OF REVIEW

6 As explained in the CRAs' original motion to dismiss,
7 "threadbare recitals of the elements of a cause of action, supported by mere
8 conclusory statements, do not suffice" to survive a motion to dismiss. *Ashcroft v.*
9 *Iqbal*, 129 S. Ct. 1937, 1949, 173 L.Ed.2d 868 (2009) (citation omitted). *See also*
10 *Rick-Mik Enterprises, Inc. v. Equilon Enterprises LLC*, 532 F.3d 963, 975 (9th Cir.
11 2008) ("[A] formulaic recitation of the elements of a cause of action will not do.")
12 (citation omitted). Instead, a plaintiff must plead "factual content [that] allows the
13 court to draw the reasonable inference that the defendant is liable for the
14 misconduct alleged." *Iqbal*, 129 S. Ct. at 1949. As the Court in this case has
15 recognized, the standard is even higher with respect to claims alleging negligent
16 misrepresentation and fraud, which require *particularized* allegations including "the
17 time, place and content" of each allegedly deceitful statement. August 4 Order at 2
18 (citing *Neilson v. Union Bank of Cal., N.A.*, 290 F. Supp. 2d 1101, 1141 (C.D. Cal.
19 2003). As the Court further recognized, Plaintiffs here have the burden to "state the
20 time, place and specific content of the [allegedly] false representations[.]" *Alan*
21 *Neuman Productions, Inc. v. Albright*, 862 F.2d 1388, 1392 (9th Cir. 1988).

22 Applying these standards, it is again plain, for the reasons detailed below,
23 that Plaintiffs are unable as a matter of law to state a claim against the CRAs.

III. ARGUMENT

A. **Plaintiffs' Claim For Negligent Misrepresentation Must Be Dismissed Because The CRAs Did Not, As A Matter Of Law, Owe Plaintiffs Any Duty Of Care**

Plaintiffs' claim for negligent misrepresentation² must be dismissed because Plaintiffs still fail to make any allegation that they stood in privity or its functional equivalent with the CRAs (as required under New York law), or that they were otherwise members of a "limited group of intended beneficiaries" of the CRAs' credit ratings (as required under California law).³

1. **Plaintiffs Fail to Plead a Duty of Care Under New York Law**

As demonstrated in the CRAs' original motion, New York case law has long provided that liability for negligent misrepresentation can exist only where

² Although Plaintiffs purport to make separate claims for negligence and negligent misrepresentation, this Court previously made clear that "Plaintiffs' claim for 'negligence' is actually a claim for negligent misrepresentation because it alleges that Plaintiffs relied on Defendants' false statements." August 4 Order. This finding is completely ignored in Plaintiffs' SAC, which simply repeats both causes of action as if they were distinct.

³ The "governmental interest" approach applied by California to choice of law questions focuses on the "interests of the litigants and the involved states." *Reich v. Purcell*, 67 Cal. 2d 551, 553 (1967). The driving consideration is the "appropriate scope" and not the "quality" of the "conflicting state policies." *Kearney v. Salomon Smith Barney, Inc.*, 39 Cal. 4th 95, 112 (2006). The "mere fact that California laws are more favorable to [plaintiff]'s claim . . . cannot make California law controlling." *Waggoner v. Snow, Becker, Kroll, Klaris & Krauss*, 991 F.2d 1501, 1507-08 (9th Cir. 1993).

These principles support the application of New York law to Plaintiffs' negligent misrepresentation claim. Both S&P and Moody's formed and published their credit rating opinions from their corporate headquarters in New York. See Exhibits 1 and 2, respectively to the September 13, 2010 Declaration of David T. Biderman in Support of the Joint Motion to Dismiss (the "Biderman Decl.") and the September 13, 2010 Declaration of Joshua M. Rubins (the "Rubins Decl."). Additionally, New York, as a global financial center, has a long history of promoting the broad dissemination of information to the marketplace and protecting that goal through the requirement that a special relationship be established before liability will attach for allegedly negligent statements. See *Ultramares Corp. v. Touche*, 255 N.Y. 170, 182-83, 174 N.E. 441, 446 (1931).

1 there is privity or a “bond . . . so close as to approach that of privity” between the
2 plaintiff and the defendant. *See Ultramares*, 255 N.Y. at 182-83. Here, Plaintiffs
3 have not alleged, and obviously cannot allege, actual privity with the CRAs. Nor
4 can they allege the alternative near-privity, which has been defined as: “(i)
5 awareness that the [allegedly negligent representations] were to be used for a
6 particular purpose or purposes; (ii) reliance by a known party or parties in
7 furtherance of that purpose; and (iii) some conduct by the defendants linking them
8 to the party or parties and evincing defendant’s understanding of their reliance.”
9 *Ossining Union Free School District v. Anderson LaRocca Anderson*, 73 N.Y.2d
10 417, 425, 539 N.E.2d 91, 95 (1989) (citation omitted).

11 It is well-established that a contrary rule, allowing plaintiffs to state a
12 claim for negligent misrepresentation absent privity or its functional equivalent,
13 would expose the speaker to the unacceptable prospect of “liability in an
14 indeterminate amount for an indeterminate time to an indeterminate class.”
15 *Ultramares*, 255 N.Y. at 179. As explained in the CRAs’ earlier submission,
16 seminal cases such as *Jaillet v. Cashman*, 115 Misc. 383, 384, 189 N.Y.S. 743, 744
17 (Sup. Ct. N.Y. Co. 1921), *aff’d* 235 N.Y. 511, 139 N.E. 714 (1923), long ago
18 recognized that an investor who relies to his detriment on incorrect information that
19 is broadly disseminated (*e.g.*, over a news ticker service as in *Jaillet*) cannot state a
20 claim because he is “but one of a public to whom all news is liable to be
21 disseminated.” Any other standard, the court held, would make the defendant
22 potentially liable “to every member of the community who was misled by the
23 incorrect report.” *See also Daniel v. Dow Jones & Co.*, 137 Misc. 2d 94, 96-97,
24 520 N.Y.S.2d 334, 336 (N.Y.C. Civ. Ct. 1987). New York courts have consistently
25 adhered to the rule of *Ultramares* and *Jaillet*, dismissing claims where the plaintiff
26 and defendant were not in privity or its functional equivalent. *See, e.g., Vanguard*
27 *Mun. Bond Fund, Inc. v. Cantor, Fitzgerald L.P.*, 40 F. Supp. 2d 183, 189-95
28

1 (S.D.N.Y. 1999); *Security Pacific Business Credit, Inc. v. Peat Marwick Main &*
2 *Co.*, 79 N.Y.2d 695, 704-08, 597 N.E.2d 1080, 1084-87 (1992).

3 Here, the SAC still lacks *any* allegations to suggest that there was a
4 relationship, or even a casual interaction, between either of the CRAs and either of
5 the Plaintiffs. Instead, the SAC merely alleges, in misleading fashion, that the
6 CRAs “directly communicated [their] published ratings to the Plaintiffs.” SAC ¶
7 16. This threadbare allegation is plainly inadequate to satisfy the near-privacy
8 standard. Indeed, the SAC itself goes on to clarify that this allegation of “direct”
9 communication means only that the ratings were included in a Fixed Income
10 Offering Report provided to Plaintiffs by their broker (SAC ¶¶ 8, 10, 12, 14).
11 Plaintiffs further admit (as they must) that the CRAs “published” these ratings to
12 the market at large. *See e.g.*, SAC ¶ 17-19. Regardless of whether Plaintiffs were
13 among the recipients of these broadly published ratings, or whether the ratings also
14 ended up in a report provided to Plaintiffs by their broker, no such allegations can
15 constitute the sort of relationship or communications that could satisfy the near-
16 privacy standard under New York law. *First Equity Corp. of Florida v. Standard &*
17 *Poor’s Corp.*, 689 F.2d 175, 179 (2d Cir. 1989) (affirming application of *Jaillet* to a
18 case brought against S&P and making clear that even a subscription agreement
19 would not place a plaintiff in privacy). Again, Plaintiffs fail to allege anything that
20 would distinguish themselves from any of the hundreds of thousands of investors
21 around the world who may have considered the CRAs’ widely available rating
22 opinions. *See, e.g.*, SAC ¶ 17.⁴

23 Nor can Plaintiffs allege (as they must) that (i) the CRAs published their
24 Fannie Mae and Freddie Mac ratings for the “particular purpose” of inducing
25 Plaintiffs’ reliance; (ii) the CRAs “specifically agreed” to prepare their ratings for

26 ⁴ Plaintiffs continue to confuse the ratings scale employed by each of the
27 CRAs as demonstrated in the ratings reports, attached as Exhibits 1 and 2,
28 respectively to the Biderman Decl. and the Rubins Decl.

1 Plaintiffs' intended use; or (iii) the CRAs had "specifically agreed" to provide them
2 with a copy of the ratings. *Ultramares*, 255 N.Y. at 553. To the contrary,
3 Plaintiffs continue to acknowledge (as they must) that these ratings, which
4 addressed the creditworthiness of publicly traded securities issued by large, well-
5 known government sponsored entities ("GSEs"), were made available to the vast
6 investing public. Plaintiffs do not (and cannot) make any allegation that the ratings
7 were intended for their own specific use, or the use of any other particular investor.
8 Plaintiffs thus cannot allege a duty of care under New York law, and their claim for
9 negligent misrepresentation must fail.

10 **2. Plaintiffs Alternatively Fail To Plead A Duty Of Care Under**
11 **California Law**

12 Plaintiffs' SAC similarly fails to allege the existence of a duty of care
13 under the law of California, which follows Section 552 of the Restatement (Second)
14 of Torts (1977). *See Bily v. Arthur Young & Co.*, 3 Cal. 4th 370, 407-15 (1992)
15 (recognizing that liability for negligent misrepresentation "is limited to loss
16 suffered . . . by the person or one of a limited group of persons for whose benefit
17 and guidance" information is provided). Similar to the *Ultramares* rule, the
18 "limited group" requirement is designed to "promote[] the important social policy
19 of encouraging the flow of commercial information upon which the operation of the
20 economy rests." *See* Restatement § 552 cmt a. The California Supreme Court held
21 in *Bily* that Section 552 limits liability for negligent misrepresentation to instances
22 where information is transferred "with the intent to induce plaintiff, or a particular
23 class of persons to which plaintiff belongs, to act in reliance upon the representation
24 in a specific transaction, or a specific type of transaction, that defendant intended to
25 influence." 3 Cal. 4th at 414 (citation and internal quotation marks omitted). Here,
26 as noted above, Plaintiffs still fail to allege any facts upon which to infer that they
27 were a member of any limited group of intended beneficiaries of the CRAs' ratings,
28 or that the CRAs intended to induce their reliance in any transaction.

One instructive case on this point is *In re Enron Corp. Securities, Derivative & "ERISA" Litigation*, 511 F. Supp. 2d 742, 808-27 (S.D. Tex. 2005), in which the court overseeing the multidistrict *Enron* litigation dismissed negligent misrepresentation claims against S&P. The plaintiff in *Enron*, similar to Plaintiffs here, alleged that the CRAs "failed to exercise reasonable care or competence in obtaining and communicating accurate information concerning the creditworthiness of Enron" and that they published "false and misleading credit information" concerning the company. *Id.* at 808-09. Applying Connecticut law, which is similar to Section 552, the court found that the CRAs owed no duty of care because the plaintiff failed to allege any contact in connection with its transaction with Enron, and was thus no different than any of the countless investors, counterparties and others who might have consulted ratings on Enron. *Id.* at 826-27.

This Court has previously discussed the significant r[o]le played by the Credit Rating Agencies in the efficient operation of capital markets, which would be chilled by unlimited liability for creditworthiness ratings, while public policy clearly encourages "continued vigorous participation in the activity." . . . [A]llowing anyone to sue credit rating agencies who had read the credit rating reports and claimed to have relied upon them and lost money in any endeavor that person undertook would be far more deleterious than beneficial to society as a whole.

Id. at 827 (citation omitted). The *Enron* court also recognized the serious chilling effect that would result if any of the countless potential plaintiffs who might claim to have relied on defendants' credit ratings could state a claim for negligent misrepresentation:

To vigorously participate in the credit rating industry, which provides useful information for investors, Rating Agencies must be allowed to maintain independence and objectivity and not be swayed by risk of

1 unlimited liability for errors to either issuers or investors; instead the
2 market should be the appropriate means for ensuring the reliability of
3 credit opinions and of rating agencies.

4 *Id.* at 815.

5 Finding that no duty of care existed – or could have existed – between plaintiff and
6 the rating agencies, the court dismissed the plaintiff’s claim with prejudice. *Id.* at
7 827.

8 The same continues to be true here, where Plaintiffs simply cannot allege
9 that they had any contact with the CRAs that would differentiate them even slightly
10 from the world of other prospective investors with access to the CRAs’ broadly
11 disseminated opinions about Fannie Mae and Freddie Mac. *See* SAC ¶ 17
12 (acknowledging that Moody’s and S&P both “published” their ratings to the
13 public). For this reason, Plaintiffs negligent misrepresentation claim must fail
14 under both New York and California law.

15 **B. Plaintiffs Have Failed To Allege Sufficiently The Additional Elements**
16 **Necessary To State A Claim For Negligent Misrepresentation**

17 A claim for negligent misrepresentation under both New York and
18 California law also requires a plaintiff to allege that (i) “the defendant made a false
19 representation that he or she should have known was incorrect;” (ii) “the
20 information supplied in the representation was known by the defendant to be
21 desired by the plaintiff for a serious purpose;” (iii) “the plaintiff intended to rely
22 and act upon it; and” (iv) “the plaintiff reasonably relied on it to his or her
23 detriment.” *Hydro Investors, Inc. v. Trafalgar Power Inc.*, 227 F.3d 8, 20 (2d Cir.
24 2000).⁵ Similar to Plaintiffs’ two prior pleadings, the SAC again fails to allege
25 these necessary elements under any standard, much less the heightened standard
26 that applies under Rule 9(b). *See Glen Holly Entertainment, Inc. v. Tektronix, Inc.*,

27 ⁵ These remaining elements are essentially the same under the laws of New
28 York and California. *Compare Hydro Investors, Inc.*, 227 F.3d at 20, with
Bily, 3 Cal. 4th at 407.

1 100 F. Supp. 2d 1086, 1093 (C.D. Cal. 1999); *Aetna Cas. and Sur. Co. v. Aniero*
2 *Concrete Co.*, 404 F.3d 566, 578-84 (2d Cir. 2005).

3 As a threshold matter, the SAC includes no new allegations to satisfy the
4 first critical element to state a claim for negligent misrepresentation – a knowing
5 misstatement. As noted, Plaintiffs’ SAC reflects only cosmetic revisions to the
6 dismissed FAC, including a new allegation that “Defendant [S&P] represented to
7 Plaintiffs that Fannie Mae with a dividend rate of 8.25 percent rated AA3” [sic] and
8 that “[t]hese representations, and every other representation referred to in this
9 Second Amended Complaint were made to the Plaintiffs in California.” While this
10 allegation purports to identify the CRAs by name, as well as the ratings at issue and
11 the place of the alleged misrepresentations, nowhere does the SAC address – as it
12 must to state a claim – “how” or “why” the CRAs’ ratings were false.

13 The law is clear that to state a claim, Plaintiffs are required to set forth the
14 circumstances underlying the alleged misrepresentation, including not only “the
15 time, place and content” of each statement, but also the “circumstances indicating
16 falseness.” *In re Glenfed*, 42 F.3d at 1547-48; *see also Ebeid ex rel. U.S. v.*
17 *Lungwitz*, 2010 WL 3092637, at *4 (9th Cir. August 9, 2010). As explained in the
18 CRAs’ original memorandum, this would require in this case, among other things,
19 specific allegations to demonstrate that the rating analysts responsible for the
20 CRAs’ ratings of Fannie Mae and Freddie Mac did not *genuinely believe* in those
21 specific rating opinions. *See Apollo Capital Fund, LLC v. Roth Capital Partners,*
22 *LLC*, 158 Cal. App. 4th 226, 243 (2d Dist. 2007) (recognizing that negligent
23 misrepresentation must be a “misrepresentation of a past or existing material fact . .
24 . without reasonable ground for believing it to be true”).

25 This principle has been recognized repeatedly in a series of recent cases
26 involving the CRAs, each holding that in order for a credit rating opinion to
27 constitute an actionable false statement, a plaintiff must allege that the CRA
28 analysts responsible for that rating opinions did not truly hold the views expressed.

1 For example, in a recent decision dismissing claims brought against the same
2 CRAs, the court in the *In re Lehman Bros.* litigation held that for credit rating
3 opinions to be actionable, “*the complaint must allege that the ratings agencies did*
4 *not truly hold those opinions at the time they were made public.*” *In re Lehman*
5 *Bros. Securities and ERISA Litigation*, 684 F. Supp. 2d 485, 494-95 (S.D.N.Y.
6 2010) (emphasis added). Similarly, in *In re IndyMac Mortgage Backed Securities*
7 *Litigation*, 2010 WL 2473243, at *11 (S.D.N.Y. June 21, 2010), another securities
8 fraud case decided recently, the court recognized that “[r]atings are opinions and
9 therefore actionable under the Securities Act only if not truly held by the ratings
10 agencies when issued.” And in *New Jersey Carpenters Vacation Fund v. Royal*
11 *Bank of Scotland Group, PLC*, 2010 WL 1172694, at *14 (S.D.N.Y. Mar. 26,
12 2010), the court held that “credit ratings . . . are statements of opinion, as they are
13 predictions of future value and future protection of that value. . . . *Plaintiffs can*
14 *only demonstrate an actionable misstatement if ‘the opinion is both (1) not believed*
15 *by the speaker and (2) objectively untrue.’”* (emphasis added) (citation omitted).
16 *See also Tsereteli v. Residential Asset Securitization Trust 2006-A8*, 692 F. Supp.
17 2d 387, 394-95 (S.D.N.Y. 2010); *New Jersey Carpenters Health Fund v. DLJ*
18 *Mortgage Capital, Inc.*, 2010 WL 1473288, at *8 (S.D.N.Y. Mar. 29, 2010); *New*
19 *Jersey Carpenters Health Fund v. Residential Capital, LLC*, 2010 WL 1257528, at
20 *6 (S.D.N.Y. Mar. 31, 2010).

21 Nor can Plaintiffs state a claim by simply repeating conclusory allegations
22 contained in their dismissed FAC, e.g., that S&P’s and Moody’s ratings of Fannie
23 Mae and Freddie Mac were “misleading and omitted material facts” (SAC ¶ 18)
24 and that the CRAs “had knowledge that Fannie Mae and Freddie Mac were in
25 financial trouble and were bad risks.” *Id.* As noted, these exact allegations failed
26 previously and they must fail now for the same reasons. Put simply, they are far
27 too conclusory and do not constitute the sort of particularized allegation required to
28

1 state a claim for negligent misrepresentation under California law and Rule 9(b).⁶
2 *See Ebeid ex rel. U.S.*, 2010 WL 3092637, at *4; *Glen Holly Entertainment, Inc.*,
3 100 F. Supp. 2d at 1093.

4 The SAC is also still devoid of any requisite allegation that S&P and
5 Moody's knew these particular Plaintiffs would use their ratings on Fannie Mae and
6 Freddie Mac bonds for any particular purpose. This, too, compels dismissal as a
7 matter of law. *See Bily*, 3 Cal. 4th at 414-15. Nor can Plaintiffs as a legal matter
8 allege that their purported reliance on the CRAs' credit ratings was reasonable, as
9 required to satisfy the third element of a negligent misrepresentation claim. That is
10 because the CRAs' respective credit rating reports contained express cautionary
11 language about the nature of their rating opinions and their proper use.

12 The credit ratings and observations contained herein are solely
13 statements of opinion and not statements of fact or recommendations
14 to purchase, hold, or sell any securities or make any other investment
15 decisions. Accordingly, any user of the information contained herein
16 should not rely on any credit rating or other opinion contained herein
17 in making any investment decision.

18 *See Biderman Decl.*, Ex. 1 and 2; *see also Rubins Decl.* Ex. 1 and 2. As explained
19 in the CRAs' original memorandum, this sort of clear and unambiguous disclaimer
20 provides an independent ground for dismissal of Plaintiffs' claims as a matter of

21 ⁶ Plaintiffs also copied various allegations from their prior pleading (*compare*
22 FAC ¶¶ 29-30, *with* SAC ¶¶ 30-31, 38-39) that are parroted from a July 2008
23 SEC Report that dealt exclusively with the CRAs' ratings of structured
24 finance securities, and which the Court has already found to be insufficiently
25 particularized as a matter of law. *See* August 4 Order at 2. These allegations
26 have no bearing on the alleged falsity of the ratings here – Fannie Mae and
27 Freddie Mac preferred shares are not structured finance securities and the
28 SEC Report is unrelated to them. Nor do Plaintiffs identify the respective
roles played by S&P and Moody's, instead continuing to lump them together
as if they were a single actor despite the Court's explicit ruling that such
lumping together is impermissible as a matter of law. August 4 Order, at 2.
See also, e.g., SAC ¶ 18; ¶¶ 30, 31.

1 law. *See Quinn v. McGraw-Hill Cos.*, 168 F.3d 331, 336 (7th Cir. 1999) (affirming
2 dismissal of a misrepresentation claim against S&P on grounds that the investor
3 “was responsible for doing his own homework about the risks he was assuming”
4 and was on notice that an S&P rating was “not a recommendation to buy, sell, or
5 hold” a security).

6 Because Plaintiffs have failed to plead any of these necessary elements —
7 and certainly failed to do so with the requisite particularity — their claim for
8 negligent misrepresentation must be dismissed.

9 **C. Plaintiffs Have Failed To Allege With Particularity The Elements**
10 **Necessary To State A Claim For Intentional Misrepresentation**

11 Plaintiffs also have not pled — and cannot sufficiently plead — any of the
12 elements necessary to state a claim for intentional misrepresentation under New
13 York or California law. *See Anderson v. Deloitte & Touche LLP*, 56 Cal. App. 4th
14 1468, 1474 (1st Dist. 1997) (requiring plaintiff to allege “(i) misrepresentation
15 (false representation, concealment, or nondisclosure); (ii) knowledge of falsity
16 (scienter); (iii) intent to defraud (i.e., to induce reliance); (iv) justifiable reliance;
17 and (v) resulting damage”).⁷

18 First, as demonstrated above, Plaintiffs do not allege any knowingly false
19 statement that could give rise to a fraud claim against the CRAs. *See* 10-13, 13 n.6,
20 *supra*. Courts have repeatedly dismissed fraud claims in cases, such as the present,
21 where a plaintiff fails to allege that the defendant held a subjective belief that its
22 stated opinion was unsupportable. One such case, *In re Merrill Lynch & Co.*, 273
23 F. Supp. 2d 351, 368-75 (S.D.N.Y. 2003), *aff’d sub. nom. on other grounds Lentell*
24 *v. Merrill Lynch & Co.*, 396 F.3d 161 (2d Cir. 2005), is particularly instructive. In

25 ⁷ We cite to California law in this section because, unlike the law regarding
26 negligent misrepresentation, there is no substantive difference between the
27 laws of New York and California with respect to intentional
28 misrepresentation. *Compare Anderson*, 56 Cal. App. 4th at 1474, *with Wynn*
v. AC Rochester, 273 F.3d 153, 156 (2d Cir. 2001).

Merrill, the court dismissed claims brought by investors who claimed to have relied to their detriment on certain equity research reports issued by Merrill Lynch. The court dismissed the claims because plaintiff failed to allege that the equity ratings were inconsistent with opinions truly held by defendant's analyst:

Nowhere in [the complaints] is it specifically alleged precisely *which* analysts had *which* conflicts of interest involving *which* investment banking deals leading to *which* . . . research reports being misleading, to what degree, and when. (emphasis in original).

* * *

Plaintiffs . . . must allege particular facts, *for each and every rating challenged* [and] that Merrill Lynch and [its analyst] did not hold the opinion or had no reasonable basis for believing the opinion. . . . Allegations regarding the motivation to attract investment banking business are not specific contemporaneous data or information inconsistent with the opinions.

Id. at 371-73. *See In re Salomon Analyst Level 3 Litig.*, 350 F. Supp. 2d 477, 489 (S.D.N.Y. 2004) (Lynch, J.) (finding that opinions are actionable as misstatements only if the plaintiff can “demonstrate that the statement of opinion is both objectively and subjectively false. It is not sufficient for these purposes to allege that an opinion was unreasonable, irrational, excessively optimistic, not borne out by subsequent events, or any other characterization that relies on hindsight or falls short of an identifiable gap between the opinion publicly expressed and the opinion truly held”) (citations and internal quotation marks omitted); *see also supra* at 11-12 (citing the recent series of cases addressing the non-actionability of credit rating opinions); *Anderson*, 56 Cal. App. 4th at 1474.

Again, it is not sufficient for Plaintiffs merely to repeat an allegation contained in their dismissed FAC that S&P's and Moody's ratings of Fannie Mae

and Freddie Mac were “misleading and omitted material facts.” SAC ¶ 18. Nor is it sufficient for Plaintiffs to allege broadly without factual support that the CRAs “had knowledge that Fannie Mae and Freddie Mac were in financial trouble and were bad risks.” *Id.* Plaintiffs are required instead to allege “*factual content*” to support an allegation that each of the CRAs did not believe in each of the ratings at issue. *See Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 556, 127 S. Ct. 1955, 1965-66, 167 L.Ed.2d 929 (2007). *See also In re Wyse Technology Sec. Litig.*, 744 F. Supp. 207, 208 (N.D. Cal. 1990). Because Plaintiffs have not pled – and in good faith cannot plead — sufficient facts to establish an entitlement to relief, their intentional misrepresentation claim must be dismissed with prejudice.⁸

D. The Credit Rating Agency Reform Act Of 2006 Expressly Preempts Plaintiffs’ Negligence And Negligent Misrepresentation Claims

Plaintiffs’ claims for negligence and negligent misrepresentation are also preempted by the CRARA, which is the federal regulatory regime for rating agencies such as S&P and Moody’s. In relevant part, the CRARA provides:

The [SEC] shall have *exclusive authority* to enforce the provisions of this section in accordance with this chapter with respect to any [NRSRO], if such [NRSRO] issues credit ratings in material contravention of those procedures relating to such [NRSRO], including procedures relating to the prevention of misuse of nonpublic information and conflicts of interest Notwithstanding any other

⁸ Nor can Plaintiffs satisfy the other elements of their putative fraud claim, *i.e.*, there is no allegation that S&P or Moody’s had any intent to induce Plaintiffs’ reliance on their ratings and, in any event, any such reliance would have been unreasonable in light of the clear disclaimers present in each of the CRAs’ published reports. *See supra* at 13; *Quinn*, 168 F.3d at 336. Additionally, Plaintiff Paul Rice’s exclusive reliance on the credit ratings was *per se* unjustifiable based the Uniform Prudent Investor Act, which is followed in California and provides, *inter alia*, that trustees “shall exercise reasonable care, skill, and caution” in satisfying the trustee’s obligation to act as a “prudent investor.” Cal. Prob. Code § 16047(a).

1 provision of law, neither the [SEC] nor any State (or political
2 subdivision thereof) may regulate the *substance* of credit ratings or the
3 *procedures and methodologies* by which any [NRSRO] determines
4 credit ratings.

5 15 U.S.C. § 78o-7(c)(1) - (2) (emphases added).⁹ The first clause in this provision
6 makes clear that the SEC has “exclusive” regulatory authority where an NRSRO is
7 alleged to have issued ratings in “material contravention” of its procedures. This
8 provision helps ensure that NRSROs will not be subject to competing authorities,
9 but rather the centralized oversight of the SEC. The second clause provides that
10 “notwithstanding” any other law, the substance of ratings and the methodologies
11 used to generate them are not matters for any external regulation. Thus, while the
12 SEC – and the SEC alone – is responsible for regulating an NRSRO’s adherence to
13 its own procedures, *even the SEC* is not empowered to regulate the substance of
14 those procedures or an NRSRO’s credit ratings. This balancing reflects Congress’
15 recognition of the national importance of credit ratings and the vital need to protect
16 the ability of the CRAs to make their best independent analytical judgment free of
17 concern about later second-guessing if events turn out differently than they
18 anticipated when they issued their opinions.

19 This interpretation of CRARA is consistent with Congress’ goal of
20 ensuring independently derived ratings while at the same time preventing
21 fraudulent conduct on the part of the credit rating agencies. In striking a balance
22 that precludes private rights of action against the CRAs, Congress made clear that
23 governmental enforcement actions remained a viable regulatory tool to prevent
24 intentionally fraudulent or deceitful conduct. *See* 15 U.S.C. § 78o-7(o)(2)
25 (“Nothing in this subsection prohibits the securities commission . . . of any State

26 ⁹ The term “nationally recognized statistical rating organization” (“NRSRO”)
27 refers to those rating agencies that: (i) are registered with the SEC; and (ii)
28 otherwise satisfy the requirements set forth at 15 U.S.C. § 78c(a)(62).

1 from investigating and bringing an enforcement action with respect to fraud or
2 deceit against any nationally recognized statistical organization.”). A recent law
3 review article on the preemptive effect of CRARA makes just that point,
4 concluding that “[b]oth Supreme Court jurisprudence and the ordinary meaning of
5 ‘regulate’ point toward construing that word to include private causes of action in
6 the context of a preemption clause.” Timothy M. Sullivan, Note, *Federal*
7 *Preemption and The Rating Agencies: Eliminating State Law Liability to Promote*
8 *Quality Ratings*, 94 Minn. L. Rev. 2136, 2153 (June 2010). The article concludes,
9 after detailed analysis of the CRARA language and relevant cases, that it was likely
10 that “Congress intended to preempt all claims against rating agencies registered as
11 NRSROs except enforcement actions brought by regulatory agencies on theories of
12 rating agency fraud or deceit.” *Id.* at 2156. Such preemption, the article explains,
13 reflects the Congressional goal of improving ratings quality in part by promoting
14 uniformity across jurisdictions.

15 Here, Plaintiffs base their claims against the CRAs on allegations that, for
16 example, the ratings: (i) “were not substantiated by the known facts”; (ii)
17 communicated “that Fannie Mae and Freddie Mac preferred stock [had been] . . .
18 rated on the basis of current, accurate and complete data and analysis using
19 reasonable and true models” and “had been rated by objective, independent third
20 parties whose impartiality was not impaired by significant conflicts of interest”; (iii)
21 “were false because the models, data and assumptions used to rate Fannie Mae and
22 Freddie Mac were unreasonable, false, and based on pure speculation”; and (iv)
23 were based on “eased [] credit-rating methods, [and] inaccurate and stale
24 information” resulting from the CRAs’ alleged attempts to compete with rival credit
25 rating agencies. *See, e.g.*, SAC ¶¶ 25, 30, 31. These allegations make clear that
26 Plaintiffs seek to engage in the very sort of after-the-fact second-guessing of
27 analytical substance, procedures and methodologies that Congress prohibited by
28 this express preemption provision.

Courts — including the United States Supreme Court — have repeatedly interpreted language such as that contained within the CRARA as constituting an explicit announcement of Congress’ preemptive intent. *See Cisneros v. Alpine Ridge Group*, 508 U.S. 10, 18, 113 S. Ct. 1898, 1903, 123 L.Ed.2d 572 (1993) (“As we have noted previously in construing statutes, the use of such a ‘notwithstanding’ clause clearly signals the drafter’s intention that the provisions of the ‘notwithstanding’ section override conflicting provisions of any other section.”) (citations omitted). This language includes an intent to preempt civil claims brought by private litigants. *See, e.g., San Diego Building Trades Council v. Garmon*, 359 U.S. 236, 247, 79 S. Ct. 773, 780, 3 L.Ed.2d 775 (1959) (“[R]egulation can be as effectively exerted through an award of damages as through some form of preventive relief. The obligation to pay compensation can be, indeed is designed to be, a potent method of governing conduct and controlling policy.”); *Mendes v. Medtronic, Inc.*, 18 F.3d 13, 18 (1st Cir. 1994); *Heftel v. General Motors Corp.*, 1988 WL 19615, at *2 (D.D.C. Feb. 23, 1988); *cf. BMW of North America, Inc. v. Gore*, 517 U.S. 559, 572 n.17, 116 S. Ct. 1589, 1598 n. 17, 134 L.Ed.2d 809 (1996).¹⁰

The Supreme Court has addressed the preemption of state claims recently in an analogous case. *See Riegel v. Medtronic, Inc.*, 552 U.S. 312, 128 S. Ct. 999, 169 L.Ed.2d 892 (2008). In *Riegel*, the Court considered a provision of the Medical Devices Act (“MDA”), which provides in relevant part that “no State or political subdivision of a State may establish or continue in effect . . . any requirement” regarding the safety or effectiveness of medical devices, if such requirement is different from, or in addition to, any requirement under Federal law. 552 U.S. at

¹⁰ *See also City of Cleveland v. Ameriquist Mortgage Securities, Inc.*, 621 F. Supp. 2d 513, 518 (N.D. Ohio 2009) (“Without question, common law actions for damages represent an important manner of regulating conduct . . . [and] the judicial process can be viewed as an extension of a government’s regulatory power.”).

1 316 (citation omitted) (emphasis added). The Court found that this language
2 preempted all “common-law claims challenging the safety and effectiveness of a
3 medical device given pre-market approval by the [FDA]” *Id.* at 312, 315. In
4 finding that the MDA’s preemption provision reached common-law claims, the
5 Court explained that “[a]bsent other indication, reference to a State’s
6 ‘requirements’ includes its common-law duties” *Id.* at 324 (emphasis added).
7 Even more broadly than the language at issue in *Riegel*, the language of the
8 CRARA is worded so as to preempt all forms of regulation — including common-
9 law liability. Indeed, given Congress’ clear intent to preclude both the SEC — the
10 NRSROs’ exclusive regulator — and the States from regulating the substance of an
11 NRSRO’s credit ratings or rating methodologies, it would be a strange result to
12 permit juries across the country who are not experts in this complicated area to
13 develop and enforce varying standards for ratings methodologies through the
14 imposition of common-law liability, while the SEC — an agency with specific
15 expertise and “exclusive authority” to oversee NRSROs — is prevented from doing
16 the same. *See Riegel*, 552 U.S. at 324; 15 U.S.C. § 78o-7(c)(1).

17 Here, Congress has struck the balance in the public interest between the
18 need for oversight and the need to preserve the independence of the CRAs’
19 opinions. Plaintiffs’ negligence and negligent misrepresentation claims are thus
20 preempted by Federal law, which requires dismissal with prejudice.

21 **E. Plaintiffs’ Negligence And Negligent Misrepresentation Claims Against**
22 **The CRAs Must Be Dismissed For The Additional Reason That They**
23 **Are Barred By The First Amendment to the United States Constitution**

24 Plaintiffs’ negligence and negligent misrepresentation claims must be
25 dismissed on the additional ground that they are barred by fundamental principles
26 of constitutional law. Courts have repeatedly held that because the credit ratings
27 published by S&P and Moody’s are, by their nature, predictive opinions on matters
28 of public concern, they are entitled to receive full constitutional protection under
the First Amendment to the United States Constitution. Alternatively, courts have

1 also found that credit ratings are entitled to protection under the actual malice
2 standard arising under the First Amendment, *i.e.*, S&P and Moody's are entitled to
3 the same constitutional protections as other providers of financial information of
4 public interest and, as such, cannot be liable for their published statements absent
5 proof they made the statements with "knowledge of falsity or reckless disregard for
6 the truth."¹¹

7 **1. Credit Ratings Are Opinions Entitled to Full First Amendment**
8 **Protection**

9 As noted, it is well-established that credit ratings are "opinions" that
10 inherently are not capable of being proven true or false. *See supra*, at 11-12 (five
11 recently decided cases in which this point was emphatically reaffirmed).

12 The United States Court of Appeals for the Sixth Circuit agreed with this
13 position when it observed in *Compuware*:

14 A Moody's [credit] rating is a predictive opinion, dependent on a
15 subjective and discretionary weighing of complex factors. We find no
16 basis upon which we could conclude that the credit rating itself
17 communicates any provably false connotation. Even if we could draw
18 any fact-based inferences from this rating, such inferences could not be
19 proven false because of the inherently subjective nature of Moody's
20 ratings calculation.

21
22 ¹¹ The nature of the ratings business has been the subject of opinions issued by
23 federal courts around the country that have recognized that credit rating
24 agencies such as S&P and Moody's are, at their core, financial publishers.
25 *See, e.g., In re Scott Paper Co. Sec. Litig.*, 145 F.R.D. 366, 367, 369 (E.D.
26 Pa. 1992) ("S&P rates and comments on the creditworthiness of public
27 companies and their securities and disseminates that information to the
28 public. . . . S&P maintains editorial control over the form and content of its
publications and over the decision whether to publish any particular rating.");
In re Pan Am Corp., 161 B.R. 577, 579 (S.D.N.Y. 1993) ("S&P assesses,
rates and comments on the creditworthiness of domestic and international
corporate and governmental debt instruments.").

1 *Compuware Corp. v. Moody's Investors Services, Inc.*, 499 F.3d 520, 529 (6th Cir.
2 2007).

3 The court held that rating opinions could not provide the basis for a
4 cognizable claim premised on their asserted falsity. *Id.* Another appellate court
5 reached the same result with respect to Moody's allegedly false opinion about
6 creditworthiness, expressed in words ("negative outlook") rather than a letter rating.
7 *Jefferson Co. Sch. Dist. v. Moody's Investors Svcs., Inc.*, 175 F.3d 848, 852, 855-56
8 (10th Cir. 1999) (holding that "a statement of opinion relating to matters of public
9 concern which does not contain a provably false factual connotation will receive
10 full constitutional protection" and that a rating agency's evaluation of
11 creditworthiness is a "protected expression of opinion") (citation and internal
12 quotation marks omitted).

13 Plaintiffs' allegations that the CRAs' ratings were "misleading" cannot be
14 squared with these cases which are rooted in the notion that there is no such thing
15 as a "false idea" or a "false opinion." *See Gertz v. Robert Welch, Inc.*, 418 U.S.
16 323, 339-40, 94 S. Ct. 2997, 3007, 41 L.Ed.2d 789 (1974) ("[T]here is no such
17 thing as a false idea. However pernicious an opinion may seem, we depend for its
18 correction not on the conscience of judges and juries but on the competition of
19 other ideas."). Based on the principles set out by the Sixth Circuit in *Compuware*
20 and the Tenth Circuit in *Jefferson County*, dismissal is also required here.¹²

21
22 ¹² A state court in California, in an unreported decision, overruled a demurrer
23 last April to a negligent misrepresentation claim against the CRAs, over
24 arguments, *inter alia*, that the claim was barred by the First Amendment.
25 *California Public Employees' Retirement System v. Moody's Corp., et al.*,
26 No. 09-490241, 2010 WL 2286924 (Cal. Super. Ct. May 24, 2010)
27 ("CalPERS"). With respect to the First Amendment, the Superior Court
28 recognized that "under typical circumstances, the First Amendment protects
ratings agencies." *CalPERS*, at *5 (citing *Abu Dhabi*, 651 F. Supp. 2d at
175-6). The Superior Court declined to apply that protection because it
concluded that the ratings opinions at issue there concerning "structured
investment vehicles" were not a matter of "public concern." Whatever the
merits of that analysis as to public concern in that context, the Superior

1 **2. Plaintiffs Have Not Alleged Actual Malice**

2 Another line of cases, also rooted in the First Amendment, provides an
3 additional basis for dismissal. These rulings – which require that a plaintiff plead
4 and prove “actual malice” – focus less on the opinion nature of ratings and more on
5 the need to avoid chilling the speech of those who provide information on matters
6 of public concern, lest they refrain from doing so to avoid the dangers of prolonged
7 and potentially crippling litigation.

8 The actual malice standard, first enunciated by the Supreme Court in *New*
9 *York Times v. Sullivan*, 376 U.S. 254, 279-80, 84 S. Ct. 710, 726, 11 L.Ed.2d 686
10 (1964), supplies the “breathing-space” the First Amendment requires. *Id.* at 272.
11 Under this standard, an allegedly false statement about a matter of public concern
12 cannot give rise to liability unless the statement is made “with knowledge that the
13 statement was false or with reckless disregard [for] whether or not it was true.”
14 *Hustler Magazine v. Falwell*, 485 U.S. 46, 56, 108 S. Ct. 876, 882, 99 L.Ed.2d 41
15 (1988). The actual malice standard limits liability for “either innocent or negligent
16 misstatement,” and guards against the “grave hazard of discouraging the press from
17 exercising [its] constitutional guarantees.” *Time, Inc. v. Hill*, 385 U.S. 374, 389, 87
18 S. Ct. 534, 543, 17 L.Ed.2d 456 (1967). Recklessness under the actual malice
19 standard “is not measured by whether a reasonably prudent man would have

20 Court’s analysis in *CalPERS* in fact *supports* application of the First
21 Amendment here. This *is* the “typical” case to which the *CalPERS* and *Abu*
22 *Dhabi* opinions refer. Here, there can be no serious dispute that: (i) the
23 CRAs’ ratings of Fannie Mae and Freddie Mac — two large, well known
24 GSEs whose securities are traded publicly — were matters of public concern;
25 and (ii) that those ratings were disseminated broadly. *See* SAC ¶ 17
26 (acknowledging that CRAs’ ratings of Fannie Mae and Freddie Mac were
27 “published”); Biderman Decl., Ex. 1 and 2; Rubins Decl., Ex. 1 and 2. *See*
28 *also Jefferson County*, 175 F.3d at 563 n.3 (“Given the importance of
financial information to investors and the economy as a whole, bond rating
constitutes a matter of ‘public concern.’”); *In re Enron*, 511 F. Supp. 2d at
825. Thus the decision in *CalPERS* does not serve as a bar to — and in fact
supports — the application of the First Amendment defenses available to the
CRAs in this case.

1 published, or would have investigated before publishing.” *St. Amant v. Thompson*,
2 390 U.S. 727, 731, 88 S. Ct. 1323, 1325, 20 L.Ed.2d 262 (1968). Instead, the test is
3 whether “the defendant in fact entertained serious doubts as to the truth of his
4 publication.” *Id.*; see also *Bose Corp. v. Consumer Union of United States, Inc.*,
5 466 U.S. 485, 511 n.30, 104 S. Ct. 1949, 1965 n.30, 80 L.Ed.2d 502 (1984) (stating
6 that there is no “actual malice” unless “the defendant realized that his statement was
7 false or [] *subjectively* entertained serious doubt as to the truth of his statement”) (emphasis added).
8

9 Courts have consistently and explicitly held that the actual malice
10 standard applies with full force to claims (like Plaintiffs’) made against the CRAs
11 regarding their rating opinions. For example, in *County of Orange*, the plaintiff,
12 Orange County, sued S&P for breach of contract and professional negligence,
13 arising out of allegedly “inaccurate” ratings of the County’s debt. The County
14 claimed that as a result of relying on S&P’s ratings, it incurred large debts and was
15 forced to declare bankruptcy. The court granted S&P’s motion for summary
16 judgment in part, finding that the County’s debt obligation was a matter of public
17 importance and holding that the claims were subject to the actual malice standard.
18 *County of Orange v. McGraw-Hill Cos.*, 245 B.R. 151, 157 (C.D. Cal. 1999)
19 (“Because the County alleges harm arising from S&P’s expressive activity,” *i.e.*, its
20 published credit ratings, “the County must . . . satisfy the heightened pleading
21 standards of the First Amendment.”) (internal quotation marks omitted).

22 Similarly, in the *Enron* case, plaintiff’s failure to plead actual malice
23 provided an independent basis for dismissal of plaintiff’s claims against the rating
24 agencies. See *Enron*, 511 F. Supp. 2d at 825 (dismissing claims because plaintiff
25 “ha[d] not alleged facts showing that the CRAs were at fault because they knew or
26 had significant suspicions that their statements were false and thus acted with actual
27 malice”). In reaching its determination, the court cited to, among other authorities,
28 the Supreme Court’s decision in *Harte-Hanks Communications, Inc. v.*

1 *Connaughton*, 491 U.S. 657, 688, 109 S. Ct. 2678, 2696, 105 L.Ed.2d 562 (1989),
2 which held that “failure to investigate before publishing, even when a reasonably
3 prudent person would have done so, is not sufficient to establish reckless
4 disregard.” *See also Compuware Corp.*, 499 F.3d at 526-28.

5 Here, the CRAs’ ratings on publicly issued debt issued by two large GSEs
6 are plainly matters of public concern and Plaintiffs can make no allegations that,
7 even on the most generous reading, could satisfy the actual malice test. As noted,
8 the SAC alleges at most that S&P and Moody’s were “aware that Fannie Mae and
9 Freddie Mac were in financial trouble and were bad risks” when they published
10 their ratings. SAC ¶ 18. This sort of conclusory allegation is wholly insufficient to
11 support a finding of actual malice in connection with the Fannie and Freddie
12 ratings. *See Enron*, 511 F. Supp. 2d at 825 (finding insufficient the “conclusory
13 allegations regarding the CRAs” because such allegations do not “satisfy any of the
14 specific, enhanced pleading requirements established by courts to overcome First
15 Amendment protection”). Setting aside for a moment this fatal deficiency, even the
16 rote repetition of the correct legal standard, without more, would not be sufficient to
17 constitute actual malice. *See Barger v. Playboy Enterprises, Inc.*, 564 F. Supp.
18 1151, 1156 (N.D. Cal. 1983) (conclusory allegation that defendant acted
19 “recklessly” was insufficient to constitute an allegation of actual malice); *Shamley*
20 *v. ITT Corp.*, 869 F.2d 167, 173 (2d Cir. 1989) (allegations of malice “must be
21 supported by sufficient evidentiary facts”). Plaintiffs’ negligence and negligent
22 misrepresentation claims must therefore be dismissed as a matter of law.

23 IV. CONCLUSION

24 For the reasons set forth above, the CRAs’ motion to dismiss should be
25 granted, and Plaintiffs’ claims should be dismissed with prejudice.
26
27
28

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